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## Briefing on the Agribusiness Enabling Environment



# AgCLIR LESSONS FROM THE FIELD: STARTING A BUSINESS



The business of agriculture occupies a critical space in most economies. Distinct and special among industries, agriculture is the dominant source of employment for a large share, even a majority, of the population in developing nations.

Accordingly, governments treat the regulation of agriculture and food differently than any other sector. Unlike the output of other sectors, many agricultural products are basic necessities: agriculture provides the food, fiber, fuel, and construction materials necessary to sustain human existence. Governments everywhere assume responsibility for assuring that the distribution of agricultural commodities is great enough and equitable enough to provide a reasonable quality of life for its citizens.

*Agriculture and Agribusiness: Starting a Business* is a briefer that mirrors the analytical framework used by the World Bank Group's "Doing Business" series ([www.doingbusiness.com](http://www.doingbusiness.com)) and adopted by USAID's Commercial Legal and Institutional Reform framework. Divided into four sections (Legal Framework, Implementing Institutions, Supporting Institutions, and Social Dynamics), this briefer highlights the specific issues that must be addressed in local legal, regulatory, and institutional environments if agribusiness is to be economically productive, contribute to environmental sustainability, and assure a safe and reliable food supply.

## STARTING AN AGRIBUSINESS: KEY CONCEPTS

Starting an agricultural business—an agribusiness—can be as simple as clearing an unclaimed plot of land, growing a crop of potatoes, and selling them in a nearby retail market or as complex as investing in a sophisticated manufacturing plant capable of using complex chemical extraction to turn tons of corn into products for consumption or industrial use.

Most agricultural enterprises, even when oriented to production for the market, are managed by individual farmers or households who produce crops on land secured only with traditional tenure rights. They rarely enter into written contracts, have little access to formal credit, insurance, or other means to manage business risks, and rely upon unpaid, family labor in the production process. Similarly, most traders in agricultural products, also agribusinesses, operate through informal networks that collect products from producers, process them minimally (if at all), store commodities for only short periods, and resell them in local or regional markets with little regard for quality standards or packaging.

Those countries that encourage agribusinesses to move beyond informal status—to register within a state-operated registry, acquire licenses, and pay taxes—set the stage for a variety of positive outcomes. When such measures are made available and promoted, agribusinesses are better able to:

- access external financing for start-up investment and growth;
- manage their business risks; and
- expand their access to market opportunities.

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It follows that national treasuries are then in a better position to receive the taxes they need to support the country's infrastructure—roads, ports, electrical lines, and other resources that support a vibrant economy. Workers can be protected from abuse and can access health care, pensions, and other social benefits. Basic necessities will become safer through fair regulation. Important environmental values and ecosystem services can be protected. And those who own or operate such agribusinesses are likely to become more engaged local and national political life.<sup>1</sup>

## LEGAL FRAMEWORK

As the regulation of agribusiness becomes more complex, it is increasingly important that the legal framework associated with actually starting a business is made as thorough, simple, and equitable as possible. Without special attention to this need, entrepreneurs are less likely to initiate a business, and existing agricultural businesspeople are less likely to volitionally bring their businesses under the official authority of the framework.

**Company law.** This governs business organizations and is likely to provide the framework for the legal start-up of medium- to large-scale agribusinesses, including those owned by foreign investors, though even for small agribusinesses a company law will likely provide default provisions:

*Company Law sets forth requirements for forming a company, including requirements as to the minimum capital needed for formation and the procedures for registering a company. Company Law also sets forth basic principles or rules of Corporate Governance—that is, the rules that outline the division of roles and responsibilities between company management, boards of directors and supervisory boards, investors or shareholders, employees, and outside stakeholders.<sup>2</sup>*

Company law also typically defines the conditions upon which the most basic businesses—usually sole proprietorships—exist.

The growth of agribusiness tends to be comparable to the growth of other industry in a developing economy. In the short term, most developing economies are likely to experience the development of a limited number of public company or joint-stock company agribusinesses. The most rapid short- and medium-term growth would be expected to occur among closely held companies, partnerships, or limited liability companies, but actual growth would clearly depend upon the efficacy of regulatory and institutional reform.

Efficacious implementation of a company law crafted to address the special characteristics of agribusinesses enables agribusinesses to grow and prosper. Such company law might include measures to require:

- agribusinesses to delineate their rights and responsibilities with regard to the use of natural resources and to produce or maintain ecosystem services in operations;
- governments to provide access and/or security of tenure over natural resources to companies when outright ownership of such resources is not an option;
- corporate boards to recognize their roles and responsibilities regarding the use and maintenance of the “natural

capital” as well as financial capital invested in agribusiness operation; and

- all interested parties to agree on the standards for public health and safety that will apply to agribusinesses' operations.

**Cooperative law.** In many economies, the largest group of agribusinesses may be too small to qualify as small- and medium-size enterprises under whatever company law is in place. For these micro- or small-scale enterprises, the first step to acquiring the status of legal agribusiness may be joining a cooperative. A cooperative law, therefore, may be a critical element of the law for the agricultural sector. Further, the promotion of sound principles of corporate governance provides an essential foundation to the success of cooperative agribusinesses, no matter their size.

Current development practice encourages agricultural cooperatives as sound business strategy for boosting smallholder production and/or marketing. Agribusiness-oriented cooperatives can provide members with collective access to finance; economies of scale in input purchase; information that enables them to better manage individual and collective risks; and greater and more stable access to markets offering higher prices (including export markets).

In many developing countries, the legacy of socialist economic policies of the 1960s to the 1990s laid a poor foundation for the formation of business-oriented agricultural cooperatives. Forced membership, excessive control by state bureaucracies, and government-controlled non-market pricing policies characterized the earlier “cooperatives.” This experience has made today's agricultural producers and processors wary of joining market-oriented cooperative businesses. Nonetheless, since 1990, significant legislative reform in Europe, Africa, and Asia (though not in Latin America) has resulted in cooperative laws modified to reflect changes in the global business environment.<sup>3</sup>

To be fully supportive of the evolution of agribusiness, a cooperative law in developing countries should:

- acknowledge a definition of cooperatives as distinct from other forms of business organizations;
- define conditions for *voluntary* membership and member;
- promulgate rules regarding internal and external financing and creditor rights;
- develop rules on officers, directors, and governance (including between individual cooperatives and apex structures, e.g., a cooperative union); and,
- recognize, support, simplify, and encourage the use of both formal and alternative forms of dispute resolution.

These elements of a cooperative law are similar to those of a company law for corporations and limited liability companies. However, governance of cooperatives is typically provided by cooperative members rather than designated non-members, and shareholder votes are typically unrelated to the level of production of any member. Governance rules for cooperatives must be especially clear given the potential number of individual members in cooperatives, the likely wide range of educational disparities among members (which opens opportunities for corruption and exploitation of some members for the benefit of others), unequal treatment of male and female members, and

<sup>1</sup> See USAID and Booz Allen Hamilton (BAH), *Commercial Law and Microeconomic Reform: A Practical Guide to Program Implementation* (March 2007), at 4. This publication, hereafter referred to as “the Guide,” can be found at [www.bizlawreform.com/CLIRTechPub-r2b.pdf](http://www.bizlawreform.com/CLIRTechPub-r2b.pdf).

<sup>2</sup> *Id.* at 7.

<sup>3</sup> Henry Hagen, “The Creation of a Supportive Environment in Theory and Practice: Cooperative Law. Is it Necessary, Is it Sufficient for Cooperatives to Prosper?” Draft paper for meeting jointly organized by the Division for Social Policy and Development, UN, and the government of Mongolia, May 2002.

the potential for government intervention in various aspects of agricultural production, processing, and marketing undertaken by the cooperative. The government may provide additional rules for cooperative function for legitimate reasons (health and food safety, taxation, research) as well as for reasons that are less legitimate (forced surrender of commodities to meet urban consumer needs in times of shortage, excessive taxation).

Agribusiness, for the reasons outlined above, remains a heavily regulated industry in virtually any type of economy. It is critical, therefore, in order to preserve predictability for those who enter the industry or who are in a growth phase, that the legal framework is made as simple and transparent as possible and that the rules are complementary and reconcilable.

It is equally important that laws and administrative rules *related* to the establishment of a business (e.g., those governing the acquisition and use of land, and the acquisition and disposition of animals) are consistent, fair, and transparent.

**Competition law.** Laws governing abuse of dominant positions in a market, the formation of cartels, and the activity around mergers and acquisitions can have a powerful effect on the growth of whole sectors, including those relevant to agribusinesses. Many countries single out cooperatives among agricultural producers as being exempt from competition laws' prohibitions against competitor collaboration. To be exempt, these agricultural cooperatives tend to need some formal requirements spelled out in the law, including registration. A critical point for regulators to remember is that the collaboration among farmers could be structured as joint ventures and actually be pro competitive. At a minimum the joint ventures have to share risk and pool capital. These co-ops and joint ventures are important ways in which growers can pool resources to buy or lease equipment, provide storage facilities, and ease transportation and distribution that individually they could not afford. They also put the growers in a better negotiating position vis-à-vis powerful buyers. Importantly, they give growers a pro-competitive means of structuring collaboration that does not result in a net loss to consumers.

## IMPLEMENTING INSTITUTIONS

The implementation of a business organization/company law relies upon a number of institutions. These typically include:

- a company registrar to record the establishment of companies and the amendment of corporate documents;
- courts and judges to review and approve licensing and formation;
- government ministries such as ministries of trade or economic development; and
- a national securities commission to protect shareholder rights, undertake enforcement actions, and establish disclosure and reporting guidelines.

Streamlining of business registration procedures is emphasized in many developing countries. The *Doing Business* rankings have documented the enormous variability in four dimensions of business start-up: the number of procedures that must be completed, the time they take, the costs of required legal and professional services, and the amount of paid-in minimum capital.

Agribusinesses employing 10 or more workers are likely to fall under the jurisdiction of the above institutions in registering as businesses. However, the *Doing Business* approach does not address start-up requirements related to compliance with

specific environmental regulations. As these sorts of regulations are likely to be an issue for agribusinesses, it is an area for further inquiry and analysis.

Agricultural cooperatives (as opposed to individual agribusinesses) are likely to come under the authority of more sectoral institutions, or, given the democratic and voluntary characteristics of cooperatives, within the jurisdiction of entities responsible for local government. The process of registration is, therefore, likely to be somewhat different than it is for individual agribusiness.

Even when a cooperative law is well developed and provides for autonomous, member-managed agribusiness cooperatives, governments tend to exercise a degree of oversight over the activities of cooperatives. Generally, it appears that government organizations with sectoral responsibilities offer the most pertinent oversight, e.g., a ministry of agriculture, although several developing country governments have other configurations. In Indonesia, for example, oversight comes from a specialized Ministry of Cooperatives and Small and Medium Enterprises (SMEs); Tanzania dissolved its Ministry of Cooperatives and Community Development, and current responsibility lies with the Ministry of Agriculture, Food, and Cooperatives; and Bangladesh deposits responsibility with a Ministry of Local Government, Regional Development and Cooperatives. Whatever the ministry, there should be the capacity to establish and maintain a registrar of cooperatives.

Often, the operational staff members of implementing institutions are not in complete agreement as to the role of cooperatives in agribusiness, and practice may not be congruent with policy and law. Given the history of cooperatives as a social rather than economic movement in many European countries and North America, rules and norms governing cooperatives often reflect social and political objectives as much as they address business goals. Recently, some countries have simply included cooperatives as one element of "civil society." If cooperative agribusiness is to thrive, legal, regulatory, and oversight institutions must pay attention to how cooperative governance is structured to provide adequate business direction, guarantee shareholder value, and establish how disputes between cooperatives' officials and members (shareholders) are to be resolved.

In addition to those implementing institutions that directly govern the formation and composition of a business, other institutions may have indirect authority over formation. Many countries have established technical assistance services to help agribusinesses navigate the many difficult environmental, licensing, property, and riparian issues that may arise. It is also important, whether or not there may be a "clearinghouse" for government assistance, that the various relevant ministries provide clear, precise, and simple assistance and information.

## SUPPORTING INSTITUTIONS

Supporting institutions are those that exist exclusively or otherwise to assist, often as an intermediary between industry and the implementing institutions, people in carrying out their business productively, legally, efficiently, and safely. These institutions include universities, trade associations, research organizations, political advocacy groups, and municipal and regional business centers.

Most support for cooperative formation and operation is provided by the government ministry in charge. However, since a key rationale for forming a cooperative is collective access to



## About AgCLIR:

AgCLIR, or the Agribusiness Commercial Legal & Institutional Reform diagnostic is a unique tool for agribusiness enabling environment analysis that identifies the root causes of an inefficient or underperforming agricultural sector. AgCLIR is a sector-specific adaptation of the United States Agency for International Development (USAID) CLIR approach, which aims to improve the business enabling environments through sound analysis and strategic interventions. This series, Briefings on the Agribusiness Enabling Environment is intended to shed light on some of the most important, and least understood, components at the intersection of agribusiness and commercial law and institutional reform. All issues are available at <http://egateg.usaidallnet.gov/EAT>

credit, banks, both private and state owned, are often deeply engaged with the agricultural community. Cooperatives often receive training or support from institutions tasked with promoting microfinance or SME development.

Support from multilateral organizations and donors is also important in the cooperative sector. The international Committee for the Promotion and Advancement of Cooperatives (COPAC) is a public/private partnership focusing entirely on cooperative law and operations. The UN agencies that are members of COPAC offer a range of advisory and support services for cooperative development in developing countries. The Food and Agriculture Organization (FAO) and the International Labour Organization (ILO) appear to be the most active in this regard.

The United States offers bilateral assistance for cooperative development and operations. The National Cooperative Business Association/ Cooperative League of the USA (NCBA/CLUSA), the ACDI/VOCA, and many other private voluntary organizations (PVOs) and contractors emphasizing SME development have supported cooperative agribusinesses. USAID's Development Credit Authority (DCA) works with these organizations and private banking institutions in developing countries to increase agribusiness cooperatives' access to credit.

## SOCIAL DYNAMICS

In addition to the legal and institutional foundations necessary to catalyze growth in the agricultural sector, a number of foundational issues unique to agricultural business need to be included in an analysis of the sector. Start-up agribusinesses are first and foremost affected by the geography and topography of a country. But perhaps most important, prevailing political and cultural attitudes towards agriculture shape the role of the state in the agricultural economy. Economic governance issues can be seen as one of the leading causes of poor agricultural performance in an economy: overwhelming state involvement in agribusinesses, provision of private rather than public goods (e.g., fertilizer and seeds rather than roads and canals), and distorted import markets suffering from high costs and low quality resulting from too little

competition are a few of the most important indicators of the social dynamics that help determine the eventual success or failure of the agricultural sector in a given economy.

As already noted, many countries have attempted to reduce the time needed to register companies by establishing clearer guidelines for the process and often by establishing "one-stop shops" to help facilitate it. Seven out of the 10 countries the World Bank ranked as leaders in business climate reform in 2006–2007 made progress in the specific area of "starting a business." Overall, this area was found to be the most popular area for reform.<sup>4</sup>

In some countries, foreign direct investors in agribusinesses have also benefited from streamlined start-up procedures and have experienced rapid returns of their investments. The rapid growth of the flower export business in Ethiopia illustrates the kind of response that changes in policy and regulation can engender.<sup>5</sup>

Cooperative businesses are also experiencing a new wave of growth after a somewhat troubled past. Too often, farmers were forced to join cooperatives if they had an interest in producing a particular crop (e.g., cotton, coffee) or if the government was strongly committed to farmer organization and control. Corruption and incompetence in cooperative management and lack of transparency of commodity pricing (especially when the crop was exported) undermined the concept of cooperatives as agribusinesses.

Newly organized cooperative agribusinesses are attempting to overcome this history. Organizers are focusing on the principles of the cooperative movement with regard to membership rights and responsibilities. Governments are moving toward positions of support rather than positions of control over democratic, business-oriented cooperatives. Instability of commodity prices on global markets combined with increased competition among agricultural exporters (e.g., cotton, coffee) will continue to challenge cooperative agribusinesses, though. Adequate reporting, shareholder protection, and dispute resolution mechanisms will be vital if agricultural cooperatives are to survive.

<sup>4</sup> See [http://www.doingbusiness.org/documents/FullReport/2008/DB08\\_Full\\_Report.pdf](http://www.doingbusiness.org/documents/FullReport/2008/DB08_Full_Report.pdf), at 4.

<sup>5</sup> See <http://www.africafirst.com/stories/200705300964.html>.

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